

## Econ 2013 Study Guide For Exam 1

### Chapter 1

- Know that Economics is the study of how we make choices under scarcity
- Understand the concept of scarcity
  - Scarcity- the concept that there is less of a good freely available from nature than people would like.
    - Not the same thing as poverty!
    - Example: time, money, textbooks
    - Scarcity necessitates rationing
      - Rationing- allocating scarce goods to those who want them.
      - In a market economy, price is used to ration goods.
    - Scarcity leads to competitive behavior.
  - Choice- the act of selecting among alternatives
- Know the difference between the different kinds of resources that we use to produce economic goods
  - Resources: an input used to produce economic goods.
    - Human resources (human capital)
    - Physical resources (physical capital)
    - Natural resources
  - Capital: Human-made resources used to produce other goods and services.
- Know the 8 guideposts to economic thinking:
  1. Resources are scarce, so tradeoffs must be made (Know the concept of opportunity cost)
    - i. Opportunity cost: the highest valued alternative that must be sacrificed when choosing an option (highest valued activity sacrificed in making a choice)
      - a. Ex: going to college; monetary cost: tuition, books; non-monetary cost: forgone earnings
        - i. If the opportunity cost of college rises, then one will be less likely to attend college.
  2. Individuals are rational: They try to get the most from their limited resources
    - a. "Greatest benefit at least possible cost"
    - b. Ex: red wine vs. spiced rum; welfare vs. education
  3. Incentives matter: choice is influenced in a predictable way by changing incentives.
    - i. As personal benefits (costs) from choosing an option increase, other things constant, a person will be more (less) likely to choose that option.
      - a. Ex: economic lesson from my father; prices
  4. Individuals make decisions at the margin

- i. Marginal: effect of change in current situation (benefits and costs of one more) Example: Olive garden; trip to taco bell
  - ii. Cost-benefit analysis: one will undergo an action when the marginal benefits outweigh the marginal costs.
    - a. Ex: walk or take bus??
- 5. Information helps us make better choices but is costly
  - i. Ex: New house vs. new notebook
- 6. Beware of secondary effects: economic actions generate both direct and indirect effects.
  - i. Secondary effects: the indirect impact of an event or policy that may not be easily and immediately observable
    - a. Ex: fuel efficiency regulations; trade restrictions
- 7. The value of a good or service is subjective
  - i. Because goods are subjective, voluntary trade creates value
    - a. Ex: how much would you buy for a pack of gum; chick-fil-a bowl tickets.
  - ii. Moving goods and services to those who value them most is a primary source of economic progress.
- 8. The test of a theory is its ability to predict
  - i. If real world events are consistent with a theory, then that theory is valid.
- Know the difference between positive and normative economic statements:
  - i. Positive economic statements are the scientific study of what is, (testable).
    - Raising minimum wage increases unemployment
  - ii. Normative economic statements are judgments about what ought to be, (not testable).
    - The government should raise minimum wage.
- Know the four pitfalls to avoid in economic thinking:
  1. Violation of the ceteris paribus principle
    - Ceteris paribus: other things constant
    - Example: buying eggs
  2. The belief that good intentions equal desirable outcomes
    - Examples: Anti-depressant medication, C&H taxi
  3. The belief that association is causation
    - Example: superstitions; sunspots and economic activity
  4. The fallacy of composition: belief that what is true for one might not be true for all
    - Example: standing at a football game; when you get a raise vs. when everyone gets a raise

Macroeconomics: focuses on how human behavior affects outcomes in highly aggregated markets such as the nations market for labor (forest)

Microeconomics: focuses on how human behavior affects the conduct of affairs within individually defined units such as households or firms (the trees)

## Chapter 2

- Understand how voluntary trade creates value and leads to economic progress (The Candy Game!)
  - The value of goods is subjective!
  - When individuals engage in voluntary exchange, both parties are made better off.
    - Channeling goods and resources to those who value them most increases the wealth created by a society's resources.
      - Transactions costs: the time, effort, and other resources needed to search out, negotiate, and consummate an exchange.
        - ❖ They reduce our ability to produce gains from potential trades.
          - Middleman (a person who buys and sells, or arranges trades) can reduce transaction costs.
  - Creation of wealth: the process by which some people become rich will make everybody richer. (Henry Ford)
- Know the characteristics and 4 incentives of private property rights.
  - Private Property rights involve:
    - The right to exclusive use of the property.
    - Legal protection against invasion from other people.
    - The right to sell, transfer, exchange, or mortgage the property.
  - 4 incentives of property rights
    - Incentive to use resources in ways that are considered beneficial to others
      - ❖ Example: Cartmen's amusement park.
    - Private owners have an incentive to care for and manage what they own.
      - ❖ Example: communal refrigerator vs. your own refrigerator.
    - Private owners have an incentive to conserve for the future
      - ❖ Example: tragedy of the commons; endangered species.
    - Private owners have an incentive to make sure their property does not damage your property
  - Lack of property rights= lack of economic progress
- Understand the concept of the Production Possibilities Curve (PPC). Be able to read a production possibilities curve and identify **efficient (point on curve)**, **inefficient (point inside of curve)**, and **unattainable points (point outside of curve)**, as well